BC Timber Sales and Road Maintenance

Complaint Investigation 030463

Forest Practices Board

FPB/IRC/97

June 2004

DOC
BC
F5675
C
C6:03
0463
2004
c.3

LEGISLATIVE
VICTORIA BC
2004

LEGISLATIVE LIBRARY OF BRITISH COLUMBIA
3 3298 00296 7520

Table of Contents

The Complaint **1**

Jurisdiction 1

Background 1

Issues 3

Investigation Approach 4

Analysis **4**

Road-Use Agreements 4

Double Billing 4

Optional Maintenance Fees 5

Maintenance Standards 5

Distortion of Stumpage Rates 6

Solving Disputes 6

Commentary of New Legislation 7

Conclusions **7**

Board Commentary **8**

The Complaint

In March 2003, four forest companies (the complainants) located in the Okanagan/Shuswap area asked the Board to investigate the fairness of legislation concerning road maintenance costs. The companies either log timber sold by government through BC Timber Sales (BCTS) or purchase logs from other companies who log through BCTS. These logs are usually hauled on roads where larger forest companies control the maintenance. The complainants are concerned that the successful bidder on a timber sale must negotiate with and pay these private interests to use the government's road. The complainants believe that this requirement is unfair because the forest company that controls the road is frequently both a competitor and customer for the timber. The complainants would like the legislation changed so that a private company with a competing financial interest cannot impose unfair costs or conditions for using a publicly-owned road.

Jurisdiction

The Board's authority to deal with this complaint is complicated, because timber pricing and issuance of tenures are matters dealt with in the *Forest Act*, under which the Board has no jurisdiction. However, road use and maintenance are forest practices in both the *Forest and Range Practices Act* (FRPA) and the *Forest Practices Code of British Columbia Act* (the Code) under which the Board does have jurisdiction. In order to understand the root of the complaint, it is necessary to examine some of the implications that the regulatory framework has on some non-jurisdictional issues.

Background

BCTS recently evolved out of the Ministry of Forests' former Small Business Forest Enterprise Program (SBFEP). The SBFEP originated in 1978 to make timber available for small logging or timber milling businesses. Applicants for BCTS timber sales must be registered and this report refers to them as registrants. The SBFEP started with unallocated timber from timber supply areas. In 1988, government reallocated 5 percent of the provincial allowable annual cut to the program. That volume logged under BCTS has now grown to account for over 13 percent of the provincial cut. Much of that volume consists of small patches within other licensees' operating areas. BCTS usually sells timber through short-term licences.

Roads for BCTS timber sales are generally short, designed to get the wood from the timber sale to the closest main haul road. The timber sale licence holder is usually responsible for maintenance on these short side roads. Another party, usually a larger licensee, is typically responsible for maintenance on the main haul roads.

Larger licensees, generally known as "major" licensees, usually hold long-term tenures. They develop and manage operating areas on Crown forest land to produce and harvest timber. Major licensees usually develop and maintain the roads in their operating areas.

They typically design the transportation systems to minimize delivery costs of timber to their mills. Consequently, they usually manage the main forest haul roads and tributary roads to their own cutting permits.

Road Tenures, Legislation and Policy

The government administers Crown forest roads in two ways. If the Ministry of Forests builds a road, upgrades a road, or assumes the responsibility for a road for hauling timber, the road is established as a **forest service road**. If a licensee does so rather than the government, the road still belongs to the Crown but it is not a forest service road; the licensee requires a road permit. FRPA allows a person with a timber sale licence to haul timber on a road that is under road permit to another person. If someone needs to haul timber on a forest service road, FRPA and the *Forest Act* requires that such a person has a **road use permit**.

Section 79(2) of the *Forest Planning and Practices Regulation* requires a road permit-holder to maintain the applicable road. For a forest service road, the Ministry of Forests may designate one road use permit-holder to maintain it. In this report, the party responsible for maintaining a road will be called the primary user, regardless of whether the road is a forest service road or one under a road permit. Others using a Crown forest road for timber hauling or other industrial purposes will be referred to as secondary users. Section 79 of the *Forest Planning and Practices Regulation* prevents anyone but the primary user from maintaining a Crown forest road.

Section 22.3 of FRPA allows a primary user to charge a reasonable fee to secondary users for maintenance, modifications or repair of damage done to the road. Before December 17, 2002, if the two parties could not agree on a reasonable fee for maintenance, they could refer the matter to the district manager for binding arbitration. During the same time period, a person hauling on a road under road permit also needed to have a road use permit. Therefore, most BCTS timber sale applications advised applicants to get a "road use agreement" with the primary user before the district manager would issue a road use permit. A road use agreement is not defined in legislation or regulation. In June of 2003, that Ministry of Forests policy changed. BCTS advised its local administrators that having a road use agreement should not be a condition of receiving a road use permit because disputes between road users for maintenance could be resolved by the new process that is currently outlined in section 22.3 of FRPA. Under the new process, if two parties cannot agree on the costs, the primary and secondary users can agree to an arbitration process. If they cannot agree on an arbitration process, then that section requires that the parties seek resolution under the *Commercial Arbitration Act*.

Stakeholders' Views

The complainants are concerned that the regulatory framework empowers primary users to charge a fee for maintenance in the absence of maintenance standards. They assert that some major licensees apply the legislation fairly, but others do not. The complainants claim that when primary users use road maintenance policy unfairly they can influence secondary users' costs, which in turn influences the price they pay for the timber and therefore primary users can manipulate stumpage rates. They assert the result is that the current legislative framework allows a primary user or their favoured logging contractors to have an unfair competitive advantage.

The complainants understand that there is legislation requiring arbitration but believe it is an impractical remedy. The complainants are concerned that government is giving control of public forest roads to major licensees. The primary user can be a customer for the logs from the timber sale or can be a customer for logs obtained in the future. The primary user can also be a supplier for raw material in the form of logs or rough stock for mills or for log traders that rely on BCTS fibre. Therefore, the complainants must maintain an amiable relationship with primary users. They believe that forcing arbitration would almost certainly result in a loss of future business.

Finally, the complainants are also concerned about unequal bargaining power. Most primary users are major licensees with more resources than the secondary users who cannot spare the manpower and cost to go through arbitration.

Primary users are concerned because they have the responsibility to maintain the roads. They are allowed to collect money for maintenance but are not given collection tools. They would like a quick and easy method to resolve disputes and ensure that the secondary users pay for maintenance.

For its part, the Ministry of Forests maintains that the current legislation and policy are adequate. A primary user can charge a maintenance fee. If the secondary user finds that it is reasonable, they will pay it; otherwise, they can proceed with arbitration. Government does not want to be involved in trying to resolve what are basically private sector economic concerns.

Issues

The investigation examined the following issues.

1. Is it fair for district managers to require road use agreements?

2. Do licensees double bill for maintenance fees?

3. Is it fair for primary users to have an option to charge maintenance fees?

4. Is it fair for primary users to charge maintenance fees without having maintenance standards?

5. Can licensees distort stumpage rates through maintenance practices?

6. Is the method for solving maintenance disputes fair?

Investigation Approach

The complainants provided real examples that illustrate problems they see with the legislation. The examples did not relate to non-compliance with the legislation or regulations. Rather, they concerned whether or not the legislation itself is fair. Therefore, rather than examining specific instances for non-compliance, the report uses examples to demonstrate why the complainants think the legislation is unfair.

Following interviews, a preliminary report was sent to the participants and other industry groups for comment and to broaden the perspective. Comments were accepted by the Board and incorporated into this report.

Analysis

Road Use Agreements

The legislation changed in December 2002. That change removed the district manager's responsibility for resolving disputes about road maintenance fees. The complainants were concerned because, until June 2003, the Ministry of Forests still required road use agreements before they would issue road use permits in some areas. Since the Ministry of Forests no longer requires road use agreements, that aspect of the complaint is resolved.

Double Billing

The appraisal system is the way the government puts a value on timber logged by major licensees. Some complainants think that it is unfair that they have to pay a maintenance fee when the government already compensates primary users for doing maintenance on the roads through the appraisal system. In essence, they consider their payment for maintenance to be double billing. The requirement to pay a maintenance fee is within the Board's jurisdiction while appraisal issues are not. Nevertheless, to examine if payment for maintenance fees is double billing, the Board must look at the calculation of stumpage.

Stumpage is a fee that licensees pay for Crown timber and it is usually calculated in terms of dollars per cubic meter of timber logged. The appraisal system allows a reduction in the stumpage rate, known as a cost estimate, to compensate for expenses that major licensees

incur to harvest Crown timber. One appraisal cost estimate category is for road maintenance. Maintenance costs depend on more factors than just the volume of timber logged. For example, it costs more to maintain a longer road than a short one and more to maintain a road that is wet than one that is frozen. Nevertheless, the cost estimate is directly proportional to the number of cubic meters logged, with no consideration of other variables. In theory, for major licensees, the cost of road maintenance and the reduction in stumpage cost due to the cost estimate for maintenance should balance in the long term.

Primary users submit actual road maintenance costs to the Ministry of Forests, which uses these costs to determine future road maintenance cost estimates. When primary users collect maintenance fees, they must submit those fees to Ministry of Forests as well. The Ministry of Forests uses all this information to determine future cost estimates. The intended result is that the maintenance fee paid by the secondary user will offset the road maintenance expense. That way, expenses incurred but reimbursed will not distort the future cost estimate. In summary, the appraisal provides an allowance for the maintenance costs incurred as a result of their operations, but not any incremental costs associated with road use by other users. Therefore, it is the Board's view that payments for maintenance from secondary users do not constitute double billing.

Optional Maintenance Fees

The complainants see inequities in the way primary users charge maintenance fees. When BCTS sells timber, the complainants say that BCTS must do so fairly. For example, if a registrant is eligible to bid and submits the highest bid, BCTS is required to award the timber sale to that bidder. However, there is no requirement for a primary user to treat BCTS registrants fairly. For example, a primary user may prefer that one specific registrant get a timber sale. They could waive some or all of the maintenance fees for that registrant, thus giving the preferred bidder an advantage in the competition.

Although in such a situation the primary user will not get a direct payment for maintenance to the road, the primary user can still recover the cost of maintenance. The preferred registrant could reimburse the primary user for maintenance costs by selling the timber to the primary user at a reduced price. Therefore, because the legislation permits primary users to charge maintenance fees unevenly, they can influence who wins a timber sale.

Maintenance Standards

When a primary user collects a maintenance fee, they can also influence costs in another way. FRPA and regulations do not require maintenance work to be done concurrent with hauling. As well, the legislation provides only a basic road maintenance standard; the primary user must only ensure that the structural integrity of the road is maintained, that the clearing width of the road is protected; that drainage structures of the road are functional, and that the road can be used safely.

If maintenance is not done at the time that the road is being used, the road condition will deteriorate in the short term and increase haul cost for secondary users. The primary user has no obligation to maintain the road to a standard that reduces haul cost. The licensee can collect money from the secondary user because the road condition has deteriorated from its use. However, they can delay maintenance work until they themselves need to haul on that road. Conversely, a primary user can create a considerable benefit to a preferred secondary user by deciding to maintain roads concurrent with the secondary user's hauling, thereby decreasing hauling cycle times.

In summary, without some standard for routine maintenance to reduce haul cost, a primary user can collect fees for road maintenance with or without providing the service concurrently, and thereby influence the relative competitiveness of secondary users.

Distortion of Stumpage Rates

The complainants suggested two ways that maintenance practices could affect stumpage rates. First, if maintenance is not anticipated to be done on roads while BCTS registrants haul, those secondary users will anticipate higher haul costs, forcing them to reduce their "bonus bids". The result may be an artificially low stumpage rate, distorting a seemingly market-based pricing system and potentially reducing revenues to the Crown.

The second way involves a primary user not charging a maintenance fee but buying the logs at a reduced price to compensate for maintenance expenses. The primary user incurs the maintenance expense and submits that expense for the Ministry of Forests to use in determining the future cost estimate for maintenance. The primary user is not required to account to the Ministry of Forests for the extra volume. This practice would tend to increase the future cost estimate. Even though that increase would be marginal in the short term, it could add up to a substantial loss of revenue in stumpage when applied over many major licensees for a full appraisal period.

The complainants contend that such practices will only increase in the future as the government continues to move toward a market-based stumpage system. It appears to the Board that primary users could distort stumpage rates through maintenance practices.

Solving Disputes

The complainants consider the new arbitration process for resolving disputes to be too onerous for their small businesses. At the same time, primary users would like assurances that they can actually collect maintenance fees.

The Board notes that there is flexibility even in the new legislation. Both sides are free to make agreements about maintenance and collection of fees. Further, if they cannot make such agreements, they are free to agree to an arbitration process other than that provided in the *Commercial Arbitration Act*. Additionally, the Board notes that the complainants have not

gone through an arbitration process and have not provided evidence to show onerous procedures.

The other concern is that secondary users need to keep a good working relationship with primary users. The Board understands the complainants' reluctance to force a primary user to arbitration; they do not want to alienate their customers. At the same time, sawmills are continually looking to increase their supply of raw logs as they increase the efficiency of their mills. It is in their best interests to attract log suppliers, not alienate them. Log traders need to satisfy both suppliers and customers. However, disputes will occur and there needs to be a method to resolve them. The Board found that, on balance, FRPA's process for resolving disputes for maintenance fees is fair.

Commentary of New Legislation

Under the previous legislation, there was no restriction to prevent secondary users from doing their own maintenance. A BCTS registrant could maintain the road to a standard that would minimize their combination of hauling and maintenance cost. The primary user could not charge for such maintenance but could still recover a smaller pro-rated fee for long term maintenance items such as culvert replacement and brushing. However since the complaint was made the legislation has changed. Now, section 22 of FRPA and section 79 of the *Forest Planning and Practices Regulation* prohibit anyone except the primary user from doing maintenance on roads. A secondary user currently has no recourse but to accept whatever standard, beyond the basic legislated standard, a primary user chooses to provide.

Conclusions

1. District managers no longer require road use agreements so that aspect of the complaint is resolved.

2. Payments for maintenance fees by secondary users and appraisal cost estimates for maintenance are not double billing.

3. Since primary users have the option to charge variable maintenance fees, they can influence who wins a timber sale.

4. The law that allows primary users to control maintenance on Crown forest roads without providing adequate standards for that maintenance is unfair.

5. Primary users could influence stumpage rates through variable maintenance practices.

6. FRPA's dispute resolution process for road maintenance is fair.

Overall, the Board found that current policy and legislation do not require primary users to be fair and consistent when dealing with secondary users; rather, policy and legislation

enable primary users to make decisions about maintenance and maintenance fees that are in their best interest and not necessarily in the best interests of other users. Therefore, the Board is of the opinion that the law that gives primary users the exclusive right to collect fees for and maintain roads without ensuring fair administration of that privilege is itself unfair.

Board Commentary

The Board recognizes that government direction, generally, is to reduce administrative burdens, not increase them. However, BCTS has the largest allocation of timber supply in the province and that allocation is expected to grow even larger to accommodate a new competitive timber pricing system. Therefore, the Board suggests that government review the regulatory framework that allows primary users to set variable maintenance fees, and consider whether it would be feasible for BCTS to identify and post road maintenance costs as part of each sale.

PO Box 9905, Stn Prov Govt
Victoria, British Columbia
Canada V8W 9R1

Phone: 250-387-7964
Fax: 250-387-7009
Toll free: 1-800-994-5899
E-mail: fpboard@gems9.gov.bc.ca

Information on the Board is on the
internet: http://www.fpb.gov.bc.ca